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In the Supreme Court of the United States

OCTOBER TERM, 1964

No. 1047

POWER AUTHORITY OF THE STATE OF NEW YORK,

PETITIONER

v.

FEDERAL POWER COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE FEDERAL POWER COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the Court of Appeals for the Second Circuit (A. 390–401)[1] is reported at 339 F. 2d 269. The opinion and orders of the Federal Power Commission (A. 226–238; 239–240; 241–243) are reported at 31 FPC 93, 467 and 962.

JURISDICTION

The judgment of the court of appeals was entered on December 8, 1964. A timely motion for rehearing

[1] Citations to "A. —" refer to the pages of the Joint Appendix and to the pages of the decision of the court of appeals, as certified by that court.

or, in the alternative, for rehearing *en banc* was denied on January 11, 1965. The decree of the court was entered on January 12, 1965. The petition for a writ of certiorari was filed on April 9, 1965. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1) and Section 313(b) of the Federal Power Act, 16 U.S.C. 825*l*(b).

QUESTIONS PRESENTED

Petitioner, a municipality within the meaning of Part I of the Power Act, constructed and operated a portion of the complete navigation and hydroelectric development in the International Rapids section of the St. Lawrence River under a license from the Federal Power Commission. Petitioner's portion consists of the American segment of the development's power works and joint power and navigation works. The other portion of the development, consisting of the power works and joint-use works located in Canada and of navigation works located in both countries, was constructed by others. The questions presented are:

1. Whether the Commission properly held that the applicability of the statutory exemption from annual charges for "projects constructed * * * by * * * municipalities primarily designed to provide or improve navigation" depends not upon whether the complete development was primarily designed for navigation but upon whether the part constructed by petitioner was so designed.

2. If so, whether the record supports the Commission's finding that petitioner's works were primarily

designed for the development of power, rather than "to provide or improve navigation."

3. Whether the Commission could reasonably hold that power sales which produce revenues in excess of cost were not sales "without profit" within the meaning of the Section 10(e) of the Act, which provides for enjoyment of licenses by municipalities "without charge to the extent such power is sold to the public without profit."

STATUTE AND REGULATIONS INVOLVED

The relevant provisions of the Federal Power Act and of the Commission's regulations are set forth in the Appendix, *infra.*

STATEMENT

In 1953, the Federal Power Commission issued a license to petitioner for the construction, operation, and maintenance of certain hydroelectric project works which are a part of the International Rapids project located on the St. Lawrence River. *Power Authority of the State of New York,* 12 FPC 172, affirmed *sub nom. Lake Ontario Land Development and Beach Protection Association, Inc.* v. *Federal Power Commission,* 212 F. 2d 227 (C.A.D.C.), certiorari denied, 347 U.S. 1015. Among the terms and conditions of the license was one providing that (A. 168–169):

> The Licensee shall pay to the United States the following annual charges:
>
> For the purpose of reimbursing the United States for the costs of administration of Part I of the Act, one (1) cent per horsepower on

> the authorized installed generator capacity (computed at 1,250,000 horsepower) plus two and one-half (2½) cents per 1,000 kilowatt-hours of gross energy generated by the project during the calendar year for which the charge is made.[2]

The license, including the above provision, was accepted by petitioner without objection. Petitioner proceeded with the construction authorized by the license, began generating power in 1958, and commenced commercial operations on August 1, 1959.

In 1959, pursuant to Section 10(e) of the Act and Article 27 of the license, the Commission sent petitioner a bill representing charges accrued during the period July 17, 1958, through December 31, 1958. Petitioner applied for exemption from such charges on two independent grounds: (1) that the project was primarily intended to improve navigation, and (2) that all power produced by petitioner either was used for State or municipal purposes or was sold to the public without profit. Under Section 10(e), either of these grounds, if established, would warrant the requested exemption.

On August 3, 1959, the Commission denied the application for total exemption but allowed a partial

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[2] By order of September 9, 1960, the Commission amended this clause to read (A. 171):

> For the purpose of reimbursing the United States for the costs of administration of Part I of the Act, a reasonable annual charge in accordance with the provisions of Part II of the Commission's Regulations (18 C.F.R. 11.20(b)). The authorized installed capacity for such purpose is 1,216,000 horsepower.

exemption based on a finding that approximately 21% of the power generated by petitioner was either used for municipal purposes or sold to the public without profit. Petitioner sought and was granted reconsideration, and the matter was set down for hearing before an examiner.[3]

The examiner's decision, rendered on July 18, 1963, reached substantially the same result. It granted the 21% exemption for 1958, and a slightly larger and similarly based exemption for 1959; in all other significant respects, it denied petitioner's application.[4]

The Commission affirmed the examiner's decision, holding (a) that petitioner's eligibility for a "navigation exemption" depended upon the purpose of the project works constructed by the petitioner itself and not upon the purpose of the International Rapids development as a whole; (b) that the project works constructed by petitioner were not primarily intended to improve navigation; and (c) that, with the exceptions noted in the examiner's decision, petitioner's sales of power were made at a "profit," as that term is defined in Section 11.24(d)(2) of the Commission's regulations (App., *infra*, pp. 15–17). Further rehearing was denied.

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[3] Prior to the commencement of the hearing on November 14, 1962, the Commission had rendered bills for 1959, 1960 and 1961, and petitioner had filed applications for exemption from such charges. It was therefore agreed between petitioner and the staff of the Commission that petitioner's obligation for the period July 17, 1958, through December 31, 1961, could be established in this proceeding.

[4] For 1960 and 1961, the examiner allowed exemption from less than one-tenth of one percent of the aggregate charges.

The Second Circuit affirmed. It accepted the Commission's definition of the navigation exemption and held that there was substantial evidence to support the Commission's finding that the project works constructed by petitioner were not primarily intended to improve navigation. The court also agreed with the Commission that petitioner's sales of power were for profit.

ARGUMENT

1. Section 10(e) of the Federal Power Act (16 U.S.C. 803(e)), which requires licensees of hydroelectric projects to pay the United States reasonable annual charges in an amount fixed by the Commission, provides, among other exceptions, that

> * * * as to projects constructed or to be constructed by States or municipalities primarily designed to provide or improve navigation, licenses therefor shall be issued without charge * * *.

Petitioner (the "Power Authority") claims an exemption under that provision on the ground that the International Rapids development as a whole, including those portions constructed by other entities, both public and private, was designed primarily to aid navigation. It is plain, however, as both the Commission (A. 229) and the court of appeals (Pet. 5a–7a) held, that the "project" whose navigational purpose is in issue under Section 10(e) is not the International Rapids development as a whole, but only those particular works which were constructed by the Power Authority itself pursuant to its license. A "project" is defined in Section 3(11) of the Act (16 U.S.C. 796(11)) as a "complete unit of improvement or development." The

Commission found that the hydroelectric works licensed to the Power Authority qualified as a "project" within that definition, since the record on the original license application showed (a) that the Power Authority "fully intended to have the hydroelectric works in operation, to provide needed power, long before the navigation facilities of the St. Lawrence Seaway were completed"; (b) that the works "were intended to be a complete and operating unit in themselves"; and (c) that all parties concerned "regarded the Authority's works as a project in themselves" (A. 228–229). These findings are supported by the evidence and therefore conclusive.

Moreover, even if the works constructed by the Power Authority were not a "complete unit of improvement or development," but an inseparable part of a larger complex comprising the entire International Rapids development, those works, rather than the development as a whole, would still be the relevant "project" under Section 10(e). It is plain on the face of that provision, that the "project" in question must be one "constructed or to be constructed" by a State or municipality and that the Commission must have issued a license "therefor." In the present case, the only segment of the overall development which was licensed by the Commission, and the only one that was constructed by a State or municipality, was the part licensed to and constructed by the Power Authority. It is that part alone, therefore, whose purpose must be tested under Section 10(e).

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That construction places no strain on the language of the statute. Strictly speaking, what the licensee constructs, and the Commission licenses, is not a "project" as such, but a specifically identified group of "project works." See Sections 3(12) (16 U.S.C. 796(12)) and 4(e) (16 U.S.C. 797(e)). We think it clear that the term "projects" was used in Section 10(e) as a synonym for "project works", and on that assumption it is plain that the term refers only to the hydroelectric works constructed by the Power Authority. The court of appeals reached substantially the same result by holding that Section 10(e) "applies to the 'project' *so far as* a license in connection therewith was issued to the Power Authority" (Pet. 7a). *Cf. Lake Ontario Land Development and Beach Protection Association, Inc.* v. *Federal Power Commission,* 212 F. 2d 227, certiorari denied, 347 U.S. 1015. The same result could also be reached by reading "projects" to mean "projects or parts thereof." Whichever approach is adopted, it is evident, we submit, that the test of navigational purpose must be applied to the Power Authority's works, and not to the overall St. Lawrence development. A contrary interpretation would mean that a licensee whose facilities were designed solely for the purpose of generating hydroelectric power could secure an exemption on the basis of navigational works constructed by others. Congress plainly contemplated no such result.

We note, moreover, that petitioner would gain no comfort even from the construction for which it argues. For, if the term "project" were read broadly to cover the entire International Rapids development,

this greater "project" would neither be "constructed by" a State or municipality nor the subject of a Commission license. Indeed, such an interpretation, as the court below pointed out, would mean that "no state or municipality, jointly engaged in improving navigation with an entity of a different kind, could ever be exempted from paying license charges" (Pet. 7a). The court below quite properly refused "to inhibit joint undertakings in this way."

Finally, we point out that petitioner accepted a license which specifically provided for the payment of annual charges. Since it did not seek review of that order, it may not challenge collaterally one of the conditions which it imposed. *Callanan Road Co.* v. *United States,* 345 U.S. 507, 512–513; *Central Nebraska Public Power & Irrigation District* v. *Federal Power Commission,* 160 F. 2d 782, 784 (C.A. 8).

2. The Commission found that the Power Authority "was concerned first and foremost with hydro-electric power" and that "[a]ny benefit to navigation was incidental to the development of power or arose from requirements imposed upon the Authority by this Commission and the International Joint Commission as conditions of it being allowed to proceed to its primary goal—development of hydroelectric power" (A. 230). That finding was amply supported. In its original application the Power Authority represented that it was "an independent agency of the State created by law to develop the hydro-electric power resources of the St. Lawrence River" and that "the project covered by this application is conceived to develop the International Rapids Section of the St. Lawrence

River for the purpose of producing and transmitting hydro-electric energy to meet present and future requirements of the region within economic transmission distance of the project" (A. 113–114). The only project works constructed by the Power Authority were those solely for power and those common to power and navigation; its works did not include those portions of the over-all St. Lawrence development which were designated as solely for navigation. Moreover, as the court pointed out, authorizations granted to the Power Authority by the International Joint Commission, the President of the United States, and the Federal Power Commission make it clear that the prime purpose of the works thereby authorized was to be the development of power (A. 187–188, 192–193, 194). The issue presented here is essentially a factual question (*South Carolina Public Service Authority* v. *Federal Power Commission,* 200 F. 2d 78, 81 (C.A. 4)), and the Commission's determination, supported as it is by substantial evidence, is conclusive (16 U.S.C. 825*l*(b)); *Universal Camera Corp.* v. *National Labor Relations Board,* 340 U.S. 474, 491).[5]

[5] Petitioner asserts that the main emphasis in the history of the development as a whole was on navigation; that the works needed solely for power accounted for only one-fifth of petitioner's costs; that the Iroquois Dam, one of the joint-purpose works constructed by it, was of no use whatever for power; that the other works would have been built differently and more cheaply if constructed for power purposes alone (Pet. 18–19); and that the project as a whole is operated primarily for the benefit of navigation (Pet. 21–22). All of these contentions were carefully considered by the court below and either rejected or found inconclusive (Pet. 8a–9a).

3. Petitioner also challenges (Pet. 23–29) the Commission's holding that it was not entitled to an exemption from annual charges under that portion of Section 10(e) which provides that "licenses for the development, transmission, or distribution of power by States or municipalities shall be issued and enjoyed without charge to the extent such power is sold to the public without profit." (App., *infra*, p. 16). Under a long-standing Commission regulation, this exemption is available only if it is shown that "the revenues from the sale of project power do not exceed the total amount of operating expenses, maintenance, depreciation, amortization, taxes, and interest on indebtedness, applicable to the project property. *Periodic accruals or payments for redemption of the principal of bonds or other indebtedness may not be deducted in determining the net profit of the project.*" (Emphasis added; 18 C.F.R. 11.24(d)(2)). In other words, in determining net profits for purposes of the exemption, the Commission permits a recoupment of all costs, including interest, plus a return of invested capital through depreciation of the physical plant and amortization of intangibles.[6]

[6] Petitioner suggests that the Commission's regulation contains an internal inconsistency since it treats amortization as an item of expense in computing net profit yet at the same time provides that payments toward the redemption of bonds or the retirement of other indebtedness are not an expense for that purpose. There is no inconsistency. Amortization, as that term is used in the regulation, refers to the gradual write-off of assets such as limited-term franchises, licenses, patent rights, limited-term interests in land, etc.

It is conceded that the revenues derived from the sale of petitioner's power exceed its costs, as defined above, and that if the regulation is valid, petitioner is not entitled to exemption. The examiner found (A. 209) that the appropriate depreciation rate on petitioner's plant is 1.25% per annum—a rate which permits recoupment of the original investment over an eighty year period. While the price at which the power is sold does not include an allowance for depreciation as such, it generates revenues which, in addition to covering all other expenses, will enable petitioner to retire its bonded indebtedness (and thereby recover its investment) over a much shorter period than would be possible through depreciation, *i.e.*, a period of thirty-five to fifty years (Pet. 31). At the end of that time, petitioner will own, free of outstanding obligations, a physical plant with a further useful life of at least thirty years. That unencumbered and still productive plant will have been paid for, in full, not by the Power Authority or its bondholders, but out of revenues provided by the customers to whom the Authority is now selling its power. In these circumstances, the Commission was justified in concluding that petitioner's present sales were not "without profit."

This conclusion is not altered by the fact that the Power Authority, having discharged its indebtedness, may thereafter reduce its rates to a level which allows for neither depreciation nor bond amortization. If, as suggested above, petitioner will have earned a profit from those sales which precede the retirement of its bonds, the Commission was warranted in finding that the statutory requirement had not been satis-

fied, despite the fact that the profit ultimately may be passed on to future customers through reduced rates which do not reflect capital costs.

The provision of the regulation here under attack, or its predecessor, has been in effect since 1938 (A. 232). Prior to this case, the definition of "profit" contained in that regulation had been challenged in only one other judicial proceeding. In 1947, the Eighth Circuit upheld the validity of the regulation and affirmed a Commission determination (*Central Nebraska Public Power District*, 5 F.P.C. 165, 169–170) that revenues yielding a return of capital in excess of that warranted by appropriate depreciation constitute "profit" within the meaning of Section 10(e). *Central Nebraska Public Power & Irrigation District* v. *Federal Power Commission*, 160 F. 2d 782, certiorari denied, 332 U.S. 765. Although Congress has subsequently amended Section 10(e), it has not disturbed the Commission's interpretation of the "without profit" clause. See Pub. L. 87–647, 76 Stat. 447. In view of this Congressional acquiescence, the administrative interpretation has acquired the force of law. *Ivanhoe Irrigation District* v. *McCracken*, 357 U.S. 275, 292–293; *United States* v. *Public Utilities Commission*, 345 U.S. 295, 314–315; *United States* v. *American Trucking Associations, Inc.*, 310 U.S. 534, 549–550.

As noted above (p. 9), moreover, petitioner's acceptance of a license specifically providing for the payment of annual charges estops it from challenging that condition. *Callanan Road Co.* v. *United States, supra; Central Nebraska Public Power & Irrigation District* v. *Federal Power Commission, supra.*

CONCLUSION

For the foregoing reasons a writ of certiorari should be denied.

Respectfully submitted,

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MAY 1965.

APPENDIX

The relevant provisions of the Federal Power Act (Act of June 10, 1920, 41 Stat. 1063. 16 U.S.C. 791–823) as subsequently amended, including amendments and additions and change of name by Title II of the Public Utility Act of 1935 (Act of August 26, 1935, c. 687, 49 Stat. 838, 16 U.S.C. 791a–825r), are as follows:

SEC. 3. [As amended August 26, 1935.] The words defined in this section shall have the following meanings for purposes of this Act, to wit:

* * * * *

(11) "project" means complete unit of improvement or development, consisting of a power house, all water conduits, all dams and appurtenant works and structures (including navigation structures) which are a part of said unit, and all storage, diverting, or forebay reservoirs directly connected therewith, the primary line or lines transmitting power therefrom to the point of junction with the distribution system or with the interconnected primary transmission system, all miscellaneous structures used and useful in connection with said unit or any part thereof, and all water-rights, rights-of-way, ditches, dams, reservoirs, lands, or interest in lands the use and occupancy of which are necessary or appropriate in the maintenance and operation of such unit;

(12) "project works" means the physical structures of a project;

* * * * *

SEC. 10. [As amended August 26, 1935, and September 7, 1962.] All licenses issued under this Part shall be on the following conditions:

* * * * *

(e) That the licensee shall pay to the United States reasonable annual charges in an amount to be fixed by the Commission for the purpose of reimbursing the United States for the costs of the administration of this Part; * * * *Provided further,* That licenses for the development, transmission, or distribution of power by States or municipalities shall be issued and enjoyed without charge to the extent such power is sold to the public without profit or is used by such State or municipality for State or municipal purposes, except that as to projects constructed or to be constructed by States or municipalities primarily designed to provide or improve navigation, licenses therefor shall be issued without charge; * * *

* * * * *

The relevant provisions of the Federal Power Commission's Regulations under the Federal Power Act, 18 C.F.R. 11.24, are as follows:

§ 11.24 EXEMPTION OF STATE AND MUNICIPAL LICENSEES.

(a) *Bases for exemption.* A State or municipal licensee may claim total or partial exemption upon one or more of the following grounds:

* * * * *

(2) To the extent that power generated, transmitted, or distributed by the project was sold directly or indirectly to the public (ultimate consumer) without profit;

* * * * *

(d) *Sales to public.* No State or municipal licensee shall be entitled to exemption from the payment of annual charges on the ground that power generated, transmitted, or distributed by the project is sold to the public without profit, unless such licensee shall show:

(1) That it maintains an accounting system which segregates the operations of the licensed project and reflects with reasonable accuracy the revenues and expenses of the project;

(2) That an income statement, prepared in accordance with the Commission's Uniform System of Accounts, shows that the revenues from the sale of project power do not exceed the total amount of operating expenses, maintenance, depreciation, amortization, taxes, and interest on indebtedness, applicable to the project property. Periodic accruals or payments for redemption of the principal of bonds or other indebtedness may not be deducted in determining the net profit of the project.

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